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THE CHARITABLE CONTRIBUTIONS DEDUCTION (REVISITED)

Paul R. McDaniel*

THIS essay explores first whether there is a theoretical case for a charitable contribution deduction ("CCD") in an income tax, staying within the context of the accepted income definition and the U.S. income tax system. Part I of the paper briefly reviews several scholarly works on the subject. Part II presents a different approach to the question whether there is a conceptual case for a CCD in the U.S. income tax system, concluding that there is such a case. Nonetheless, if a CCD is allowed, it remains true that there is considerable untaxed consumption by the beneficiaries of the organizations that receive the charitable contributions. The discussion proposes a method by which the value of this untaxed consumption can be subjected to tax. Part III discusses the changes in current law that would be required to implement the model developed in Part II, including, for example, eliminating the current limits on the deductibility of charitable contributions and extending the CCD to those taxpayers who do not itemize their personal deductions. The effects of the model on current tax expenditure analysis and practice are also considered.

I.

Scholars have advanced several different models by which the CCD can be classified either as part of a normal (or ideal) structure of an income tax or as a subsidy granted by the federal government to encourage contributions to qualified charitable organizations.¹ This Part briefly examines several approaches to the role of the CCD in an income tax.

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1. There is a lengthy list of scholarly contributions that, because of a desire to keep this essay to manageable length, are not discussed in the following analysis. Notable examples are Boris I. Bittker, *Charitable Contributions: Tax Deductions on Matching Grants*, 28 TAX. L. REV. 37 (1972); John D. Colombo, *The Marketing of Philanthropy and the Charitable Contributions Deduction: Integrating Theories for the Deduction and Tax Exemption*, 36 WAKE FOREST L. REV. 657 (2001); Mark G. Kelman, *Personal Deductions Revisited: Why They Fit Poorly in an "Ideal" Income Tax and Why They Fit Worse in a Far From Ideal World*, 31 STAN. L. REV. 831 (1979); Stanley A. Koppelman, *Personal Deductions in an Ideal Income Tax*, 43 TAX. L. REV. 679 (1988); John K. McNulty, *Public Policy and Private*

A. THE TAX EXPENDITURE MODEL

In my previous work on this subject, I accepted the view developed in the Treasury Department in the late 1960s that the CCD constitutes a tax expenditure in the U.S. income tax system and analyzed it accordingly.² Viewed from the tax expenditure perspective, the CCD is a federal matching grant program developed to encourage gifts to charity. The share matched by the government is a function of the taxpayer's marginal tax rate. As a result, the government's share of a contribution rises with the income of the donor; for each \$100 of contribution, it pays \$35 for the top income taxpayers, \$25 for those with lower incomes, and \$15 for those in the lowest marginal income tax bracket. It also follows that those utilizing the standard deduction and those with incomes below that necessary to incur positive tax liability receive no federal matching grants for gifts such individuals may make to charity. I argue that the fairness and efficiency of such a federal program, could be better achieved by a system of direct federal matching grants to charity in which the level of the federal payment rises with the percentage of income that a taxpayer gives to charity.

B. THE "IDEAL INCOME TAX" MODEL

In a landmark work, Professor William Andrews argued that a charitable contribution deduction is appropriate in the context of an ideal income tax.³ He began with Henry Simons' classic definition of personal income as the algebraic sum of a taxpayer's increase (or decrease) in net worth plus consumption between two points in time.⁴ He differentiated, however, between gifts to members of the donor's household, which should be included in the donor's taxable income, and contributions to charitable organizations, which should not be included because these expenditures produce a public or common good.⁵ The notion that a charitable contribution should be deductible because it creates a common or public good is suspect. The concept finds no support in the Simons definition of income.

Some other points of Professor Andrews' tightly reasoned argument, however, are of particular relevance to this essay. First, Andrews rejected as impractical the notion that the beneficiaries of charitable organizations

Charity: A Tax Policy Perspective, 3 VA. TAX REV. 229 (1984). As might be expected, the works analyzed in the text have some bearing on the proposals put forth in Part II.

2. See Paul R. McDaniel, *Study of Federal Matching Grants for Charitable Contributions*, in COMM'N ON PRIVATE PHILANTHROPY AND PUB. NEEDS, 4 RESEARCH PAPERS, DEP'T OF THE TREASURY 2417 (1977); STANLEY S. SURREY & PAUL R. MCDANIEL, TAX EXPENDITURES 205, 287-289 (1985) [hereinafter TAX EXPENDITURES]; Paul R. McDaniel, *Federal Matching Grants for Charitable Contributions: A Substitute for the Income Tax Deduction*, 27 TAX L. REV. 377 (1972) [hereinafter *Matching Grants*].

3. William D. Andrews, *Personal Deductions in an Ideal Income Tax*, 86 HARV. L. REV. 309 (1972).

4. HENRY C. SIMONS, PERSONAL INCOME TAXATION 49-50 (1938).

5. Andrews, *supra* note 3, at 348-51.

should include in income the value of the goods or services they receive.⁶ While Andrews correctly rejected this notion, allowing a CCD while not taxing the personal consumption resulting from the contribution constitutes a major erosion of the income tax base. Part II presents a method to deal with this problem. Professor Andrews also rejected disallowing the deduction as a proxy for taxing the beneficiaries of charities because of the likely disparate tax rate differential between contributors and beneficiaries.⁷

C. THE SUBSIDY AND EQUITY MODEL

In response to the Andrews article, Professor Mark Gergen proposed a different way of looking at the CCD.⁸ He first concluded, as suggested above, that the Andrews approach was “a reformulation of the efficient subsidy theory.”⁹ Professor Gergen then proposed that the CCD be analyzed using subsidy and equity criteria.¹⁰ He noted that the subsidy theory is premised on the notion that charities provide public goods that society desires to have furnished to charitable beneficiaries at little or no cost.¹¹ Gergen’s equity criterion was not the typical tax criterion. Rather, he asserted that donors do not receive pleasure from giving that is commensurate with that from personal consumption.¹² Accordingly, he contended that if those who give to charity are worse off (in an economic sense) than those who do not make charitable contributions, the principle of equity may defend the CCD.¹³ Professor Gergen then assessed the role of the CCD by applying the subsidy and equity criteria to three categories of charities: churches, public television, and social welfare agencies.¹⁴ He concluded that the equity criterion but not the subsidy criterion justified a CCD for contributions to churches.¹⁵ Neither criterion supported a CCD for gifts to public television, and both criteria supported a CCD for contributions to social welfare agencies.¹⁶

D. THE COMMUNITY INCOME MODEL

Professor Buckles put forth a different theory to justify the inclusion of a CCD in an income tax. He terms it the “community income theory.”¹⁷ He argued that community income should be excluded from the tax base,

6. *Id.* at 358-60.

7. *Id.* at 360-63.

8. Mark P. Gergen, *The Case for a Charitable Contributions Deduction*, 74 VA. L. REV. 1393, 1416 (1988).

9. *Id.* at 1394.

10. *Id.*

11. *Id.* at 1398.

12. *Id.* at 1426.

13. *Id.* at 1426-28.

14. *Id.* at 1433-49.

15. *Id.* at 1450.

16. *Id.*

17. Johnny Rex Buckles, *The Community Income Theory of the Charitable Contributions Deduction*, 80 IND. L.J. 947 (2005).

both on the donor's side of a contribution via a CCD and on the side of the recipient charitable organizations.¹⁸ He argued that this result is justified because this type of income "is more naturally attributed to the community rather than to the individual members of the community."¹⁹ Professor Buckles asserted that his approach rests on properly defining the tax base.²⁰ But like Professor Andrews' "common good" rationale, it is difficult to see how the community income theory is really anything more than an elaboration of the Andrews "common good" concept, a view, as noted above, that is inconsistent with the Simons definition of income.

II.

A. THE TREATMENT OF NON-CHARITABLE GIFTS

This section begins to reassess the role of the CCD in the U.S. income tax system by examining the treatment of non-charitable gifts, which overwhelmingly involve intra-familial gifts. Unless we understand the conceptual bases for the treatment of non-charitable gifts, it is difficult to examine the charitable gift area.

Assume a parent (P) gives \$1,000 to P's child (C). There are four possible income tax treatments of this gift.

1. No deduction for P and \$1,000 income to C.
2. Deduction of \$1,000 for P and \$1,000 income to C.
3. No deduction for P and no income to C.
4. \$1,000 deduction for P and no income to C.

The first approach has some support in the Haig-Simons definition,²¹ as formulated by Professor Simons.²² There are two difficulties with the approach, however. First, in Professor Simons' brief exploration of the term "consumption," he offers as a definition the "destruction of economic goods."²³ Obviously, in the gift situation, there is no destruction of economic goods by the donor; there is simply a transfer of economic value.²⁴ More fundamental to this paper is the fact that, if the donor recognizes income in the gift situation, it is in the form of psychic income derived in

18. *Id.* at 947.

19. *Id.* at 986. It would follow that beneficiaries of charitable organizations also would be untaxed.

20. *Id.*

21. SIMONS, *supra* note 4, at 49-50.

22. "The proposition that everyone tries to allocate his consumption expenditure among different goods in such manner as to equalize the utility of dollars-worth may not be highly illuminating; but there is no apparent reason for treating gifts as an exception." *Id.* at 57-58. The thesis of this paper argued that there is such a reason. Simons was quite clear that gifts should be included in the income of the donee. *Id.* at 58, 125-47 (writing much more extensively on that issue than he did on the treatment of the donor).

23. *Id.* at 50.

24. Alleged value destruction games in such situations as the family limited partnership are left aside. See James R. Repetti, *It's All About Valuation*, 53 TAX L. REV. 607 (2000); James R. Repetti, *Minority Discounts: The Alchemy in Estate and Gift Taxation*, 50 TAX L. REV. 415 (1995).

a non-market transaction, whether it be altruism, the pleasure in seeing the gift consumed by other family members, the desire for familial control, or the like.²⁵ We do not seek to reach such income in the U.S. income tax system, income from leisure being the overwhelmingly largest example. It is not clear why we should seek to reach it in the family gift context. On the other hand, taxation of the donee fits comfortably within the Haig-Simons definition.

The second approach addresses this last point. The donee has a clear accession to wealth and the amount of the gift should be included in the donee's income. Granting a deduction to the donor prevents the donor's psychic income from entering into her tax base. Under this approach, the deduction is granted not because it is necessary to define an "ideal" income tax base. Rather, it is solely a mechanism to eliminate this intangible form of income from the tax base and, hence, to treat it consistently with the treatment of other forms of psychic income.²⁶ The second approach thus has the appeal that it treats the donee properly and treats the donor consistently with others who realize various forms of psychic income in non-market transactions. As such, it has a considerable claim on equity grounds.

There are, however, two significant problems with the second approach. First, in a system using progressive rates, there could be unacceptable opportunities for income shifting within the family unit in transactions that may not change the overall economic position of the family as a whole. These transactions could be difficult for the IRS to monitor and there would be a reduction in the equity gains noted above. Second, the approach could produce insurmountable administrative problems for the IRS. Many gifts of cash could go unreported by donees, even though they were deducted by the donor, and there could be an incentive to overvalue gifts of property where the value of the deduction to the donor exceeds the increased tax burden to the donee.

Thus, despite the initial attractiveness of the second approach on equity grounds, the resulting tax avoidance and administrative problems are considerable. These problems in turn lead to the third approach: no deduction for the donor and no income to the donee. This, of course, is the current U.S. approach.²⁷ This approach accepts taxation of the donor's psychic income, while not taxing the donee, but only because it reduces the administrative problems involved in the second approach.²⁸

25. Of course, intra-familial transfers may constitute compensation for services. This analysis accepts the current somewhat uncertain line between donative and performance-based transfers.

26. The result is not necessary to prevent "double counting," that is, taxing both the donor and the donee on the same income, an approach Simons properly rejected. SIMONS, *supra* note 4, at 57-59. Although Simons seemed to think gifts were consumption expenditures by donors, he did not explain why the gift situation differed from the non-taxation of leisure, a result he approved. *Id.* at 52.

27. I.R.C. § 102(a) (West 2006).

28. Some justify the current result on the basis that it is the power to consume that should control income inclusion, not how that power is exercised. See Gergen, *supra* note

The fourth approach—deduction to donor and no income to donee—has no normative claim. That is, neither the administrative difficulties of the second approach nor the conceptual defects of the third approach justify non-taxation of the gift transaction in its entirety.

The above discussion derives the following principles:

1. Taxation of the donor's psychic income derived from making the gift should be avoided (by granting a deduction) so long as there is reasonable assurance that the value of the gift is included in income on the donee's side of the transaction.
2. Taxation of the donor (by disallowing a deduction) is appropriate when the value of the gift is not likely to be included in income on the donee's side of the transaction or administrative concerns justify such an approach.

The following discussion assesses the applicability of the above principles in the charitable contribution situation.

B. THE TREATMENT OF CHARITABLE GIFTS

Before beginning the discussion on the treatment of charitable contributions, three assumptions made in the following discussion require specification. First, I.R.C. §§ 501(c) and 509(a)(2) grant a tax exemption to public charities (the only charity considered) and deductible contributions are appropriately defined. Second, such organizations are entities rather than aggregates of individuals.²⁹ Third, current law appropriately identifies a "contribution," for example, compared to a payment for services.³⁰

The critical phrase in the above principles is "included in income on the donee's side of the transaction." In the charitable context, many would assume, if the issue was considered at all, that the donor's contribution (or the value of goods or services generated by the contribution) should be included in the income of those benefiting from the charitable organization's activities, just as under the Haig-Simons definition a donee of a

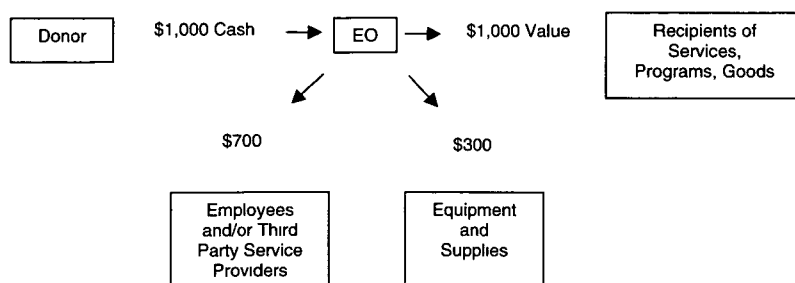
8, at 1417. See also *Helvering v. Horst*, 311 U.S. 112 (1940); Andrews, *supra* note 3, at 355. Others argue that current legal treatment of the donor is appropriate on the ground that denial of the deduction achieves the right interpersonal results among similarly situated taxpayers. For example, assume *A* and *B* each have \$1000 of income, *A* spends \$50 on a ski trip and *B* gives \$50 to a child. Each has made a personal choice as to how to spend \$50 and should therefore pay the same tax, a result reached by current law denying a deduction to *A*. This approach does not deal with *A*'s donee side of the transaction and assumes non-market and market transactions should be treated alike. If the donee is taxed, we are driven to ask why *A* is also taxed in a non-market transaction on psychic income (*B* being taxed in a market transaction in which *B* pays what the ski trip costs).

29. See TAX EXPENDITURES *supra* note 2, at 219-20, for a discussion of alternate ways to treat tax exempt organizations in tax expenditure accounts.

30. This assumption obviously is challengeable, particularly in the case of organizations such as churches, symphony orchestras, and museums. See, e.g., Gergen, *supra* note 8, at 1394. The current treatment is so well established, however, that the assumption seems reasonable.

non-charitable gift should include the gift in income.³¹

Consider the following model:



Under these circumstances, the first principle stated above would hold that a donor should receive a CCD for the \$1,000. This is because the \$1,000 should be taxable to the recipients of the services and goods. If the donor is denied the CCD in this model, then psychic income is taxed just as in the case of a nondeductible, non-charitable gift. It does not matter whether the income is derived from altruism, a desire for status in the community, power, or for some other reason.

But is it administratively feasible to tax the beneficiaries of the exempt organization's ("EO") activities, deemed to be \$1,000 in value in our example? No, because problems of tracing income to beneficiaries of charitable organizations, particularly social welfare agencies and churches, and valuation difficulties make such an approach almost impossible to implement administratively.

Does this mean, then, that the only policy choice is to deny a CCD to those who make contributions to charitable organizations? The European Union experience with the Value Added Tax ("VAT") suggests an alternative approach worth considering. A VAT is, after all, intended to tax consumption, and the treatment of charitable organizations in a VAT is instructive. Under a normative VAT, a charitable organization providing goods or services to an ultimate consumer should pay the VAT on the goods and services it purchases and should then get a credit for the VAT it has paid against the VAT it charges to its consumers (the program beneficiaries). Such an approach in a VAT, however, is as problematic as requiring income inclusion to the charitable beneficiaries in an income tax. Thus, to avoid eliminating the consumption entirely from the tax base, the Sixth Council Directive of 17 May 1977 provides that organizations that, in the U.S. context, are viewed as charitable are to be exempt from the VAT.³² In order to understand the significance of being an ex-

31. Obviously, the text statement rejects the Buckles's view, that there is something called "community income." Buckles, *supra* note 17, at 986.

32. Council Directive ("EC") No. 77/388 of 17 May 1977, art. 13.A, 1977 O.J. (L145) 1. For a European Court of Justice case discussing the meaning of the term "charitable" in the context of the Sixth Directive, see Case C-498/03, *Kingcrest Assocs. Ltd. v. Comm'rs of Customs & Excise*, 2005 ECJ CELEX LEXIS 204 (May 26, 2005).

empt entity in a VAT, a small digression into the mechanics of a VAT is necessary.

A VAT is simply a method of pre-collecting a retail sales tax on goods and services as they move more through the production-distribution system. The following example illustrates the workings of a VAT (at a ten percent rate):

	Net-of-Tax Cost	Net-of-Tax Sales Price	Tax Paid	Gross Tax Collected	Tax Credit	Government Collections
Producer	0	60	0	6	0	6
Assembler	60	80	6	8	6	2
Wholesaler	80	90	9	9	8	1
Retailer	90	100	9	10	9	1
Consumer	100	0	10	0	0	0

As can be seen, the government received the same total amount of tax as if it had imposed a ten percent retail sales tax. A large portion of the VAT, however, is collected before the final sale, and allows the government to begin collecting the tax after the first stage of production, rather than waiting until final consumption occurs at the end. Mechanically, this result is achieved by having each seller collect VAT from its purchaser, taking a tax credit for the VAT it paid to its seller, and remitting the net amount to the government.

In a VAT system, if an exemption is granted in the middle of the production-distribution chain, the government will actually collect more revenue than if the exemption was not granted. This unexpected result (from an income tax perspective) occurs because an exempt entity in the chain will pay a VAT to its suppliers but is not entitled to a credit for the amount when it sells to its purchasers (although it must collect and remit a VAT on that sale). Thus, unlike an income tax system, it is undesirable in a VAT system to be exempt from tax in the middle of the production-distribution chain. This phenomenon can be illustrated in the above example by assuming that the wholesaler is exempt from VAT.

	Net-of-Tax Cost	Net-of-Tax Sales Price	Tax Paid	Gross Tax Collected	Tax Credit	Government Collections
Producer	0	60	0	6	0	6
Assembler	60	80	6	8	6	2
Wholesaler	80	90	8	9	0	9
Retailer	90	100	9	10	9	1
Consumer	100	0	10	0	0	0

As can be seen, the government VAT collections have risen from ten percent to eighteen percent as a result of granting a VAT exemption to the wholesaler. Again, this result occurs because the wholesaler must pay VAT on its purchases but gets no credit for that payment upon its sale to the retailer.

We can now understand the significance of granting a VAT exemption to charitable organizations as does the EC Sixth Directive. In the following example, the tax exempt organization purchases goods from the retailer and distributes those goods to its beneficiaries, who are the ultimate consumers, free of charge.

	Net-of-Tax Cost	Net-of-Tax Sales Price	Tax Paid	Gross Tax Collected	Tax Credit	Government Collections
Producer	0	60	0	6	0	6
Assembler	60	80	6	8	6	2
Wholesaler	80	90	9	9	8	1
Retailer	90	100	9	10	9	1
Tax Exempt Organization	100	0	10	0	0	0
Beneficiary	0	0	0	0	0	0

Note what has occurred. The tax-exempt charitable organization has borne the final burden of the tax. The government received the full tax of ten percent VAT. In effect, the charitable organization has paid the tax on the consumption of goods by its beneficiaries. The important point to note, however, is that by granting an exemption to the charitable organization, the consumption by its beneficiaries has been subjected to the VAT.³³

The United States could adopt a similar approach to obtain some tax on the consumption of goods and services by beneficiaries of charitable organizations. A tax could be imposed on the organizations to capture part of the currently untaxed consumption. The base of the tax should be the costs of goods and services incurred by the exempt organization.

As for tax rates, a single rate could be imposed on all exempt organizations. Alternatively, varying rates could be used. For example, a very low rate, say one percent, could be imposed on social welfare organizations, reflecting the fact that the beneficiaries of such organizations would incur very little tax if the value of their consumption was included in the income tax base (indeed, some may benefit from the refundable earned income tax credit). A higher rate, say five percent, could be imposed on organizations such as museums, symphonies, and institutions of higher education, reflecting the fact that the value of the untaxed consumption of their beneficiaries is higher.

Obviously, many issues would require careful consideration, including procedures for religious institutions, state universities, and many more. But the objective of this essay is to put forth an approach that stays firmly in the context of an income tax. By permitting donors to claim a CCD, it avoids taxing psychic income, while appropriately bringing consumption

33. Although the charitable organization has paid the tax, it is possible that the organization's beneficiaries have borne the economic burden of the tax in the form of reduced goods or services.

into the tax base by taxing charitable organizations as surrogates for their beneficiaries.

III.

The following discussion identifies some specific policy approaches that would flow from the approach outlined in Part II. In addition, recent analyses of the CCD will be placed in the context of the model set forth above.

A. CCD FOR NON-ITEMIZERS

The most obvious policy implication from Part II is that the CCD should be made available to non-itemizers as well as those who itemize their CCDs.³⁴ Under the above analysis of the role of the CCD in our income tax, there is no policy justification for restricting the CCD only to those who itemize their deductions.³⁵ Non-itemizers tend to be lower income earners than itemizers. But there is no tax policy justification for restricting a normatively compelled deduction to higher income taxpayers. The tax base should not vary by income. This conclusion is reinforced by studies that continue to show that those who are in lower income brackets give a higher percentage of their income to charity than do higher income taxpayers.³⁶

The Joint Committee Staff, in its 2001 analysis of various proposals regarding the CCD, pointed to the problem of overstatement of the CCD by non-itemizers if the CCD were extended to them.³⁷ Some studies have shown that the overstatement of CCDs is a problem among itemizers.³⁸ Administrative concerns can justify a deviation from a normative approach, as discussed in Part II. It is difficult, however, to justify denying or radically limiting a CCD for *all* lower income donors just be-

34. In 2001, seventy percent of taxpayers were expected to claim the standard deduction and only thirty percent were expected to itemize their deductions. STAFF OF THE J. COMM. ON TAXATION, DESCRIPTION AND ANALYSIS OF PRESENT LAW AND PROPOSALS TO EXPAND THE FEDERAL TAX INCENTIVES FOR CHARITABLE GIVING, JCX-13-01, at 10 (2001) [hereinafter 2001 JCT ANALYSIS]. In 1998, only twenty-nine percent of returns itemized deductions. INTERNAL REVENUE SERVICE, STATISTICS OF INCOME BULLETIN, tbl. 1 (2001), http://www.irs.gov/tax_stats/soi/ind_gss.html.

35. *Matching Grants*, *supra* note 2, at 383 (viewing the CCD as a tax expenditure program, and noting that program (not tax) equity would seem to require extension of the program to non-itemizers).

36. Harvey Lipman, *Rise in Giving Tracks Growth in Americans' Income*, *IRS Data Show*, CHRONICLE OF PHILANTHROPY, Aug. 10, 2000, at 12. But, in a different study, Independent Sector found that in 1998-1999, itemizers gave 2.7% of income to charity while non-itemizers gave 1.7%. See INDEPENDENT SECTOR, GIVING AND VOLUNTEERING IN THE UNITED STATES: EXECUTIVE SUMMARY (1999), <http://www.independentsector.org/GrandV/default.html>. One problem with comparing such surveys is that the definition of "income" often is not specified. Obviously, however, higher income taxpayers give larger dollar amounts to charity than lower income taxpayers. See 2001 JCT ANALYSIS, *supra* note 34, at 13-14 tbl. 1.

37. See 2001 JCT ANALYSIS, *supra* note 34.

38. See *id.*; Joel Slemrod, *Are Estimated Elasticitys Really Just Tax Evasion Elasticitys? The Case of Charitable Contributions*, 71 REV. ECON. & STAT. 517 (1989).

cause *some* higher income donors abuse the system. Therefore, administrative concerns do not justify limiting or denying the CCD to non-itemizers.

B. LIMITATIONS ON THE CCD

Is the limit imposed by I.R.C. § 170(b)(1)(A) (stating a taxpayer's CCD may not exceed fifty percent of the taxpayer's contribution base) justified on theoretical grounds? The answer again is negative under the approach developed in Part II. If charitable contributions comprise all income expenditures, and all of that income is taxed on the EO side of the transaction, there is no reason to limit the deduction to some arbitrary percentage of income.³⁹

C. TAX EXPENDITURE ANALYSIS

If it is accepted, as argued in Part II, that a CCD is an appropriate deduction in the U.S. income tax system, it follows that tax expenditure analysis generally does not apply to the deduction, assuming that the charitable organization is taxed as suggested.⁴⁰ Tax expenditure analysis, however, would continue to apply when a deduction by the donor is not accompanied by income inclusion on the donee's side. In this situation, the interesting question is whether the tax expenditure is created in the allowance of the CCD or in the nontaxation on the charitable organization's side of the transaction. If the argument in Part II for allowing the CCD is accepted, then the tax expenditure would seem to be the nontaxation of the beneficiaries, again, either directly, or through a surrogate tax on the charitable organization.

Changing the classification of the CCD from a tax expenditure to a part of the normal structure of an income tax would have several effects. First, the "upside down" argument used in analyzing the CCD⁴¹ would be generally inapplicable on the donor's side. The argument is of no more relevance than to observe that the value of deductions for income-producing activities rises with income. Second, it would also not be appropriate to analyze the CCD as a federal subsidy in the form of a matching grant program.⁴² This result follows because the CCD is a deduction necessary to define the tax base correctly. Third, analyses of the economic efficiency of the CCD (based on the premise that the CCD is a tax expen-

39. While this discussion does not deal with gifts of appreciated property, that if the gain was fully taxable to the donor, there would be no objection in principle to allowing an unlimited CCD. But if that gain is not taxable, then limits would be required in the case of gifts of such property. In large part, the imposition of the limit in 1969 occurred because Congress did not adopt a proposal to tax the gain. STAFF OF THE J. COMM. ON TAXATION, 91ST CONG., SUMMARY OF H.R. 13270, TAX REFORM ACT OF 1969, at 27-29 (Comm. Print 1969).

40. *Matching Grants*, *supra* note 2 was predicated entirely on the proposition that the CCD constitutes a tax expenditure in its entirety.

41. The deduction increases in value with income.

42. See *Matching Grants*, *supra* note 2, at 379-95.

diture) would not be any more appropriate than analyzing the efficiency of the deduction for wages paid to workers.

CONCLUSION

The analysis in Part II of this paper supports the proposition that a CCD is an appropriate provision in an income tax system that does not tax psychic income derived in non-market transactions. That is to say that, in general, the CCD should not be classified as a tax expenditure. That proposition is subject to the condition that the amount of a CCD be included in income on the donee's side of the transaction, either by taxing charitable beneficiaries directly or, more practically, by imposing a surrogate tax on charitable organizations that receive contributions. The power of this model warrants its further exploration.